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RUEHKO/AMEMBASSY TOKYO 2617
RUEHML/AMEMBASSY MANILA 1441
RUEHBK/AMEMBASSY BANGKOK 1522
RUEHLO/AMEMBASSY LONDON 0180
RUEHHK/AMCONSUL HONG KONG 0820
RUEHSH/AMCONSUL SHENYANG 0309
RUEHOT/AMEMBASSY OTTAWA 0494
RUEHVK/AMCONSUL VLADIVOSTOK 0142
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SUBJECT: Central Bank Head: Mongolia Not Threatened by Asian Market
Downswings

REF: A) Ulaanbaatar 091 B) Ulaanbaatar 394 C) Ulaanbaatar 475 D)

Ulaanbaatar 448

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11. (SBU) SUMMARY: According to Bank of Mongolia (BOM) Governor A. Batsukh, Mongolia's exposure to turbulence in Asian markets is low, but he fears that recent moves by the US Fed could adversely affect the country's foreign currency reserves. He believes competition in the banking sector will help bring down high interest rates and weed out under-performing banks. The BOM's primary mission, he feels, is to control inflation, but he conceded that inflation will likely rise because of increasing salaries and decreasing supplies of consumer goods. He revealed that the Central Bank is still scrutinizing aspects of the controversial sale of Trade and Development Bank, and that the launch of the Bank's Financial Investigative Unit (FIU) has progressed but capacity hurdles remain. Finally, he hopes that Mongolia would soon agree with the IMF to re-start a its Mongolia. END SUMMARY.

Mongolia Unfazed By Asian Market Turbulence

12. (SBU) During a recent meeting with Econoff and Econ Assistant, Mongolia's Central Bank Governor Batsukh opined that recent fluctuations in Asian financial markets will have limited impact on Mongolia due to the country's modest foreign investment portfolio. Nevertheless, he fears that the US Federal Reserve's large scale injections of money into the US banking system, combined with interest rate cuts, could lead to higher inflation that would adversely affect Mongolia's foreign currency reserves. Other economists, business people and bankers with whom we spoke, agree that Mongolia's exposure to market swings in Asia is low. But one

banker said expected IPOs of Khaan Bank and Golomt Bank would not fetch the high prices they had previously anticipated, and that offers of cheap money once being shoved at Mongolia (reftel A) had dried up somewhat. Because easy access to cheap credit was a recent phenomenon for Mongolia, its slight evaporation is not expected to profoundly effect the economy, especially as most banks had been rightly cautious about doing deals with brokers.

¶3. (SBU) Batsukh noted that the current crisis was fueled by troubles in the US sub-prime mortgage market and, referring to the GOM's frenzied plans to sell off 40,000 apartments with government bond-backed low cost mortgages (reftel B), hoped that the GOM would take heed. The government's plan to finance low interest mortgages with competitive yielding bonds, he said, did not add up (echoing the criticism of other financial sector experts), an opinion, he says, he has already communicated to the GOM and the banking industry. "Why would banks go along with issuing low interest mortgages if the markets were demanding higher prices?" he asked.

Best Remedy for High Interest Rates: Competition

¶4. (U) Batsukh empathized with howls from Mongolia's business community that high lending rates (around 24%, or between 2 to 3 points per month) and tight repayment schedules were crippling the country's economic development (a point driven home during Econoff's recent tour of western Mongolian businesses - septel). However, he opines that the BOM has little power to affect rates; and so, focuses on keeping inflation in check. He noted that interest rates are slowly coming down and hopes they will drop below 20% by the end of this year. In his view, competition among banks will eventually force rates down. Higher rates in rural areas result from those areas being served by only one or two banks. (Note: Mongolia is home

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to 17 banks, most concentrated in Ulaanbaatar and many believed to be on shaky financial ground. End Note.)

¶5. (U) Ironically, many of Mongolia's sturdier banks complain that there is too much competition; far too many financial institutions vying for a limited number of customers by offering unrealistically high savings rates. Bankers told us the BOM needed to crack down on the desperate behavior and risky practices of weaker banks that harm the industry and keeping interest rates high. Batsukh countered that the BOM has raised the minimum reserve requirement (now at Tg 8 billion, approximately US\$6.7 million) several times since he assumed the governorship, in order to force weaker banks to fold or merge, but that all have so far survived the changes. He has also pressured smaller banks to improve corporate governance. Batsukh believes that competition will eventually weed out the weaker banks.

Banking Irregularities Are Probed

¶6. (U) Batsukh reported that the situation at the recently privatized "Savings Bank" has stabilized, with no continuation of the run on accounts that transpired after the bank revealed the disappearance of some 14 billion tg (US\$11.8 million) while under GOM management. He said he is not involved in the investigation or prosecution of the likely suspects, and left it to the police for any further comment.

¶7. (SBU) Regarding the controversial and still murky details surrounding the sale of the Trade and Development Bank (TDB), the country's largest, Batsukh contradicted earlier informal statements to us from BOM officials that the sale in toto had been approved. Rather, he said that the BOM has only approved certain portions of the sale; specifically, transactions that had taken place within the BOM's jurisdiction of Mongolia (i.e., the sale of the Asian Development Bank and International Finance Corporation's stake to new buyers). He stressed that the BOM is still carefully scrutinizing other aspects of the sale.

¶8. (SBU) He was unclear if BOM knows who the real buyers are, but said he is convinced that depositors' funds were not/not used to

finance the deal. He then asked if we had spoken with Gerald Metals (the U.S. metals trading firm that previously owned the bank) about the deal, suggesting they would have all the answers. (COMMENT: Batsukh's demeanor suggested frustration over Gerald Metals' lack of cooperation with the BOM's investigation of the sale. He hopes we might have more luck in getting answers from them. His statements might also be a backhanded way to tie an American company, and by extension the US Embassy, into some of the more questionable aspects of the sale, given that the Embassy has regularly pressed the BOM to more thoroughly investigate the deal and to make its findings available to the public. Questions surrounding the transaction led post to withdraw its accounts from TDB earlier this year. END COMMENT.)

Inflation Expected to Rise

(U) Batsukh said that despite the Bank's efforts to limit inflation under control, inflation will likely rise this year: He guessed to 8%. He blamed this on increasing fuel prices, increasing civil servant wages, and recently enacted marriage and child stipends, combined with shrinking supplies of basic consumer goods due to the rail transport problems (reftel C). A member of Mongolia's MCA National Council Batsukh believes that MCC plans to improve the railway will impact transport and shipping positively.

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19. Financial Investigative Unit's Delayed Launch

110. (U) Batsukh reported that the Financial Investigative Unit (FIU) had finally hired additional staff but conceded that it was slow-going in getting the unit up and running to effective capacity. He repeated FIU chief Tumurbat's complaint that finding qualified personnel to man the FIU, as well as locating sources of TA and financing for proper equipment, represent the greatest challenges to the FIU's successful launch. For example, he said they had only recently found someone to supply them with the software required. UNIDO will provide it for free with an annual fee to be paid by the GOM. Finally, Batsukh revealed that the BOM recently dispatched MOU texts to both Korea and Japan to coordinate efforts at fighting money laundering and terrorist financing, but had yet to hear back from either.

Mongolia and the IMF

(SBU) In what Batsukh stressed were only his personal opinions, he hoped the GOM would conclude a program with the IMF soon. He expressed frustration over the GOM's inability to effectively manage its own budget process. (Note: Last year's budget ended with a surplus of US\$186 million, or 7%, despite pledges to target for a 4% deficit and widespread budget-busting social spending by Mongolia's parliament. Parliament recently revised this year's budget when revenue projections came in much higher than expected - reftel D. End Note.) Batsukh opined that a renewed IMF program would help instill budget discipline sadly lacking in Mongolia. However, he criticizes IMF programs for being too standardized and rigid, and urges both sides to show some flexibility to enable Mongolia to enter into a new agreement. He planned to broach the subject with the IMF's Article IV Consultation team visiting Mongolia in early September.

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